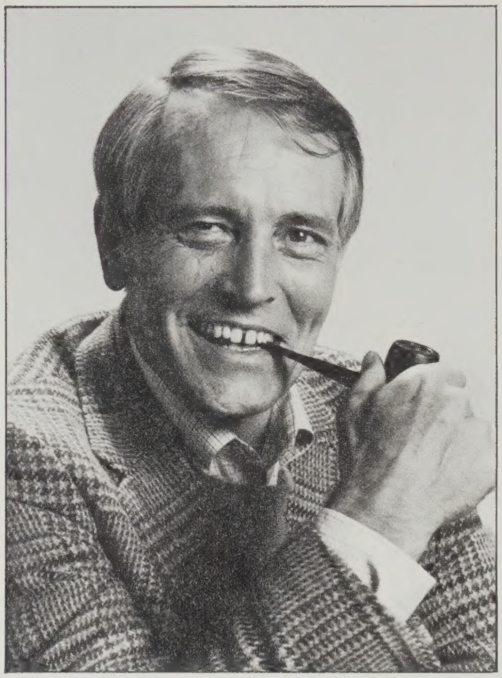
KEG RESTAURANTS LTD. Annual Report 1984



I ended my 1983 Report to Shareholders with the statement—1983 was a good year, but "you ain't seen nothing yet."

Obviously, reporting a loss from operations in 1984 was not what I had in mind. How could I have been so far off in my thinking? The questions that arise are: what went wrong; is it a temporary set-back; or is it an indication of the future? These are all questions that are legitimate for a shareholder to ask. The purpose of this report is to provide answers to these questions.

What went wrong?

My number one failing was a lack of appreciation of both the direct costs of the acquisitions: in terms of management and corporate expense; in terms of increased interest charges; and in terms of the indirect costs arising through diverting our energies and talents from running restaurants to unravelling the maze resulting from the acquisition.

As a consequence, we not only substantially increased our cost of doing business above the restaurant level, but we also failed to create Keg type of numbers from the acquired restaurants. To a lesser extent, this distraction also impacted on our existing endeavours. The financial review accompanying this report reflects the magnitude of the problem.

Let me summarize our problems:

1. A rapid escalation in our cost of doing business above the restaurant level.

	1984	1983	
	Costs as a % of sales		*$ Increase*
Regional Support	**.9**	.7	$ 376,000
Corporate Support	**1.2**	1.0	346,000
Corporate Administration	**1.8**	1.3	863,000
Interest	**1.2**	.5	1,088,000
	5.1	3.5	$2,673,000

2. A failure to generate satisfactory earnings on acquired restaurants.

- The Eastern market, where most of our new restaurants were acquired (and which now represents over 50% of our investment in restaurants) declined from a total return of $1,711,000 in 1983 to $1,196,000 in 1984 with a corresponding decline in return on investment to 10.9% in 1984 from 17.1% in 1983.

3. A certain loss of momentum in other regions as management's attention was diverted relative to the acquisitions.

Is it temporary?

The easy answer is, "Of course it is temporary." Unfortunately, this answer does not cover it all. We will overcome the critical problem areas but some will linger into 1985.

Regional support, largely in Ontario, was escalated to meet the demands of the new restaurants but is now down to target level. Corporate support was also escalated but is now coming back in line. Corporate administration had the most dramatic increase and unfortunately will also be the slowest to bring on line.

To complete the acquisitions and subsequently complete the reorganization of the entities will require higher than normal levels well into the second quarter of 1985. The same is true with interest charges. However, in each instance it is reasonable to assume that the increased cost of doing business is temporary and will eventually be brought into line.

Generating satisfactory earnings on the new restaurants is also a question of time. We are pleased with the performance of most restaurants converted.

To maximize the opportunity requires stability of management teams and well-defined support services. Great progress has been made towards this end, yet there is still a considerable way to go. This is our number one operational priority. And yes, we will achieve it.

In the meantime, we will be faced with less than optimum results in the first six months of 1985.

The Outlook

In the short term, then, the outlook is certainly more promising than 1984—1985 will be better. However, it will not be optimum as a result of some of the problems lingering from 1984.

My heavens, doesn't that sound dreary. Is there nothing positive we can say in terms of the outlook? Of course there is.

Seattle Market

- We have really turned the corner in Seattle. The market was profitable in 1984 and had the greatest turnaround of any market we are in with an improvement in total profitability of $408,000 over the previous year's.
- In addition, in late 1984 we acquired three restaurants in Seattle. These have now been converted to Kegs and are performing well above expectations.
- Finally, Wayne Holm, both an experienced Senior Operator and a Corporate Officer in charge of Support Services—and the one primarily responsible for the great surge in the Seattle market—is moving to Seattle as a base for a significant planned expansion in that market.

Montreal Market

- While we did take the writedown in Montreal, the improvement in performance in that market has been steady for the last several years. We are optimistic that the Montreal operations will be profitable in 1985 and that we will have a base for expansion in the future.

Ontario Market

- While problems exist with the conversion stores relative to creating Kegs and to getting the management teams up to par, the Ontario market as a whole has shown good increases in dinner counts. Total sales in comparative restaurants were up 17% in 1984 versus 1983.

New Products

- We have successfully introduced our fresh fish program in the Seattle market and will be introducing this program throughout Canada in 1985. The reception has been outstanding and we look forward to similar results in Canada.

People on the Move

- A significant change in 1984 which will reap the benefits in the future is the addition of Terry Thompson to our senior management team. Terry has taken over all aspects of finance and administration and has done an outstanding job for us. It is primarily through his efforts and those who work with him—including Al Rose who has been brought in from the Ontario Region to look after financial planning and Kevin Kroft who has been brought in as Controller—that our administrative costs are being brought into line.

Yes, Maude, there is still plenty of enthusiasm as to the future: we have our Sense of Mission, a commitment to the task by our people, an organization that is geared to achieve results, and finally I am still full of spit and vinegar!

We will make it all happen.

GM Tidball

George M. Tidball
President

Keg Restaurants Ltd.

Financial Review

To understand the present position and outlook for the company there is a need to understand the main components of our business. The purpose of this review is to highlight these components and their trends.

Licensing Operations

The company is primarily in the business of licensing continuing restaurant operations. The income components from this licensing business are as follows:

1) Service fees from continuing restaurants:

- These fees are the ongoing fees we earn from each restaurant within the Keg system and are primarily based upon a percentage of sales.
- In absolute numbers our income from this source has increased from $5.1 million in 1982 to $5.5 million in 1984. As a percentage of total sales it has declined from 4.1% in 1982 to 3.7% in 1984.
- The decline in 1984 reflects primarily adjustments of fees for prior periods based on our policy of relating fees not only to sales but to income. We can expect an increase in percentage earned on sales in the future.

2) Gains in sales of joint venture interests:

- These gains result from our sale of a portion of Keg's interest in existing or new restaurants. Such sales are usually made to the operator of the restaurant as part of the Company's overall policy of encouraging the operators to have an equity interest in the restaurant which they manage. Obviously these fees fluctuate depending on our general activity in the joint venturing area.

3) Regional and corporate costs:

- These are expenditures incurred by the company in order to earn the service fees.
- Regional support costs pertain to people who provide certain operational and administrative supervision in the field to the various operations under their jurisdiction.
- Corporate support costs pertain to the costs of providing various marketing, purchasing, food and training services, all of which relate to keeping the franchise viable for the future.
- The costs of regional and corporate support escalated rather dramatically in 1984, rising from an absolute figure of $2.4 million in 1983 to $3.1 million in 1984. This increase reflects the added costs of support necessary to the acquired restaurants.
- A significant reduction in the various components of these costs is expected in the future as stability of management teams is developed in the newer restaurants.

In summary, income from licensing operations experienced a reduction in 1984 of approximately $1 million. This was based primarily on the increase in the costs of support services and to a lesser extent the reduction of gain on sale of joint venture interests.

Other Ongoing Income

In addition to the income from licensing operations, the Company derives income from the investment in restaurant-related operations, from recurring income related to non-restaurant activities and recently from earnings of disposal operations.

1) Income from restaurant-related investments:

- The primary source of income from restaurant-related investments, is the return earned as a partner in the ongoing restaurants within the Keg chain. In 1984 the income from this source was $487,000 as compared to $910,000 in 1983. The reduced return related to the impact of disposal of restaurants as well as the impact of the acquisitions, both of which are discussed in more detail later in this report.
- The balance of income from restaurant-related investments is earned from Keg related real estate and from business facility leases where the Keg owns the fixed assets of groups of restaurants and leases them to the operators. While this source of income is relatively nominal at the present time it is an area of substantial growth in the future.
- It should be noted that all of these returns are based on our after-tax share of income.

2) Other Income:

- Other income basically represents income derived from non-restaurant sources but which are considered to be of an ongoing nature. In the past, this has been a source of income to the Keg. However, the 1984 write-downs in the value of restaurant investments of $1.7 million caused a loss in other income of $532,000 as compared to a gain in 1983 of $695,000. Obviously, the company feels that the writedown in the value of the restaurants is a 'one-time' consideration and that, in the future, a gain should be reflected within this category.

Other Costs of Doing Business

This component represents our corporate administration, our professional services and interest. As can be seen from the table following, the totals of these three categories escalated rather dramatically over the last three years. Total corporate administration increased some $860,000 between 1983 and 1984. As was mentioned in the President's Message, reducing these costs are a high priority.

The following table shows the Company's performance in these areas both in total dollars and as a percentage of ongoing system sales for 1982, 1983 and 1984.

Corporate Operating Income and Percentages *(Stated in $000's)*

	1984	%	1983	%	1982	%
System Sales	**$ 150,370**		$139,620		$127,391	
Licensed Operations:						
Service Fees	**5,555**	**3.7**	5,484	3.9	5,182	4.1
Gain on Sales Joint Venture Interest	**374**	**.2**	683	.5	394	.3
	5,929	**3.9**	6,167	4.4	5,576	4.4
Regional Support	**1,381**	**.9**	1,005	.7	1,424	1.1
Corporate Support	**1,784**	**1.2**	1,438	1.0	1,972	1.6
	3,165	**2.1**	2,443	1.7	3,396	2.7
Income from Licensed Operations	**2,764**	**1.8**	3,724	2.7	2,180	1.7
Restaurant Related Investments	**623**	**.4**	1,052	.7	832	.7
Other Income (Expense)	**(532)**	**(.3)**	695	.5	605	.4
Total Income	**2,855**	**1.9**	5,471	3.9	3,617	2.8
Corporate Administration	**2,148**	**1.5**	1,418	1.0	1,146	.9
Professional Services	**520**	**.3**	387	.3	347	.3
	2,668	**1.8**	1,805	1.3	1,493	1.2
Interest Expense	**1,845**	**1.2**	758	.5	533	.4
	4,513	**3.0**	2,563	1.8	2,026	1.6
Net Income Before Taxes and Extraordinary Items	**$ (1,658)**	**(1.1)**	$ 2,908	2.1	$ 1,591	1.2

Restaurant Operations

To better understand the full scope of the restaurant operations the following segmentation has been prepared.

▪ This table shows that mature restaurants continue to perform at satisfactory levels and, in fact, even the new and problem restaurants showed improvement over 1983.

▪ In essence, the decline in income relates to the disposal restaurants and the full impact of the acquisitions.

▪ Certainly the recession has had some impact on our mature stores, but we believe this impact was most noticeable in 1983. As a result, we are looking at 1985 with optimism relative to the restaurant operations.

Restaurant Performance Analysis 1982–1984 *(Stated in $000,000's)*

Restaurants	1982				1983				**1984**			
	# of Rest.	Sales	Pre-Tax Inc.	% of Sales	# of Rest.	Sales	Pre-Tax Inc.	% of Sales	**# of Rest.**	**Sales**	**Pre-Tax Inc.**	**% of Sales**
Mature Kegs	20	$ 40.8	3.1	7.6	31	$ 59.1	3.5	5.9	**32**	**$ 64.5**	**3.2**	**5.0**
New Kegs	15	19.6	(.6)	(3.4)	13	11.6	(.2)	(.2)	**5**	**7.1**	**.1**	**.1**
O.S.F./Brandy's/Other	21	23.6	.4	.2	16	21.5	.6	2.8	**10**	**10.9**	**.2**	**1.8**
	56	84.0	2.9	3.5	60	92.2	3.9	4.2	**47**	**82.5**	**3.5**	**4.2**
Problem	16	25.4	(.8)	(3.1)	16	22.8	(1.5)	(6.6)	**17**	**26.5**	**(1.3)**	**(4.9)**
Franchise	11	18.0	.4	2.2	13	16.4	.1	.6	**13**	**16.4**	**—**	**—**
Acquisitions	—	—	—	—	19	8.5	.2	2.3	**17**	**24.9**	**(.1)**	**(.4)**
Total Ongoing	83	127.4	2.5	2.0	108	139.9	2.7	1.9	**94**	**150.3**	**2.1**	**1.4**
Disposals		—	—	—		12.6	.4	—		**43.3**	**.5**	**—**
Totals		$127.4	2.5	2.0		$152.5	3.1	2.0		**$193.6**	**2.6**	**1.3**

Note: The above numbers have been adjusted to reflect three restaurants franchised in 1983 and two in 1982.

In the above table the classifications are as follows:

▪ Mature restaurants are those restaurants opened for more than two years and are profitable.

▪ New restaurants are those opened two years or less.

▪ Problem restaurants are those mature restaurants that are not profitable for reasons other than the restaurant being in the development stage.

In summary, from a financial point of view, 1984 was a difficult year. However, as the analysis shows above, we sincerely believe that the problems encountered are of a one-time nature and that 1985 will produce financial results more comparable with the past.

Consolidated Financial Statements

▶ Consolidated Balance Sheet   As At December 31, 1984

▶ Assets

	1984	1983
▶ Current Assets		
Advances and accounts receivable		
Shareholders and their related companies	**$ 108,483**	$ 425,330
Restaurants	**1,132,969**	1,423,534
Other	**307,414**	538,741
Inventories	**95,777**	241,826
Investment in assets held for disposal	**2,717,429**	709,913
Current maturity of notes receivable	**535,228**	297,914
Prepaid expenses	**39,478**	127,009
	4,936,778	3,764,267
▶ Notes Receivable, net of current maturity		
Shareholders and their related companies	**60,000**	196,786
Other	**680,220**	334, 055
	740,220	530,841
▶ Investments (Note 3)	**28,485,666**	31,975,489
▶ Fixed Assets (Note 4)	**1,606,222**	1,714,253
▶ Deferred Charges		
Deferred Income Tax	**3,291,974**	215,951
Other, net of accumulated amortization	**571,691**	817,052
	3,863,665	1,033,003
	$39,632,551	$39,017,853

Approved by the Directors:

Director: Director:

Liabilities

	1984	1983
▶ **Current Liabilities**		
Bank indebtedness (Note 5)	**$ 2,114,837**	$ 898,646
Accounts payable and accrued liabilities	**1,643,864**	1,219,128
Current maturity of long term debt (Note 6)	**5,890,050**	3,127,479
Unearned revenue	**38,180**	58,378
	9,686,931	5,303,631
Long Term Debt, net of current maturity (Note 6)	**10,742,619**	13,619,783

Shareholders' Equity

	1984	1983
▶ **Capital Stock** (Note 7)	**18,504,509**	16,780,747
▶ **Retained Earnings**	**3,870,569**	6,635,229
	22,375,078	23,415,976
▶ **Deduct Cost of Shares owned by the Company** (Note 7)	**3,172,077**	3,321,537
	19,203,001	20,094,439
	$ 39,632,551	$ 39,017,853

Auditors' Report

To the Shareholders of
Keg Restaurants Ltd.

We have examined the consolidated balance sheet of Keg Restaurants Ltd. as at December 31, 1984 and consolidated statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1984 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Vancouver, Canada
March 15, 1985

Thorne Riddell
Chartered Accountants

▶ Consolidated Statement of Income   Year ending December 31, 1984

	1984	1983
▶ Sales		
Total Restaurant Sales	**$193,660,873**	$152,622,633
Less: Disposal Stores' Sales	**43,291,216**	13,003,063
System Sales	**$150,369,657**	$139,619,570
▶ Restaurant-Related Income		
Licensing Operations		
Service Fees	**$ 5,554,739**	$ 5,484,150
Gain on sale of joint venture interests	**373,905**	682,664
	5,928,644	6,166,814
Corporate and regional support expenses	**3,165,399**	2,442,727
	2,763,245	3,724,087
Income from restaurant-related investments	**623,480**	1,052,242
Total restaurant-related income	**3,386,725**	4,776,329
▶ Other Income (Expense)		
Gain on sale of investments	**804,732**	—
Loss in value of restaurant investments	**(1,734,193)**	—
Other	**397,325**	695,256
	2,854,589	5,471,585
Less: Corporate administration	**2,668,436**	1,805,313
Interest including interest on long-term debt of $1,609,258 (1983—$543,813)	**1,845,053**	757,631
	4,513,489	2,562,944
▶ Income (Loss) before income taxes & extraordinary items	**(1,658,900)**	2,908,641
Income taxes (benefit)	**(1,310,008)**	571,351
▶ Income (Loss) before extraordinary items	**(348,892)**	2,337,290
Extraordinary items (Note 11)	**(1,523,771)**	(898,560)
▶ Net Income (Loss)	**$ (1,872,663)**	$ 1,438,730
▶ Earnings (Loss) per common share and Class A non-voting share before extraordinary item (Note 12)	**$ (.05)**	$ .46
▶ Earnings (Loss) per common share and Class A non-voting share (Note 12)	**$ (.28)**	$ .28

▶ Consolidated Statement of Retained Earnings   Year ending December 31, 1984

	1984	1983
▶ Balance at beginning of year	**$ 6,635,229**	$ 6,274,535
Net Income (Loss)	**(1,872,663)**	1,438,730
	4,762,566	7,713,265
Costs relating to the issue and reorganization of share capital, net of income tax benefit	**7,731**	137,430
Dividends	**884,266**	940,606
▶ Balance at end of year	**$ 3,870,569**	$ 6,635,229

Consolidated Statement of Changes in Financial Position   For the year ending December 31, 1984

	1984	1983
▶ **Sources of Cash:**		
Cash generated from (used for) continuing operations	$ (200,332)	$ 1,343,751
Cash generated from (used for) operating working capital:		
Advances and accounts receivable	521,892	(3,244)
Inventories	202,968	(9,114)
Prepaid expenses	87,531	(28,469)
Accounts payable and accrued liabilities	424,736	297,760
Unearned revenue	(20,198)	(102,592)
Net cash generated from operations	1,016,597	1,498,092
Other sources of cash		
Reduction in shareholders' loans	316,847	(401,626)
Increase in long term debt	1,335,459	12,433,636
Issue of capital stock, net of issue cost	859,525	4,675,992
Decrease in notes receivable	381,750	529,677
Net proceeds from sale of investments	3,734,271	377,500
Employee stock purchase plan	475,700	27,200
Conversion of warrants	86,300	—
Cash available for financing and investing activities	8,206,449	19,140,471
▶ **Uses of Cash:**		
Cash committed to financing activities		
Decrease in long term debt	1,450,054	1,281,435
Repurchase of shares	—	2,597,697
Cash dividends	582,029	782,984
Increase in notes receivable	828,443	523,175
Cash invested in future operations		
Investments including acquisitions	6,450,101	11,773,483
Deferred charges	13,876	365,813
Fixed assets	98,137	88,408
Cash used for financing and investing activities	9,422,640	17,412,995
▶ **Increase (Decrease) in bank indebtedness**	1,216,191	(1,727,476)
▶ **Bank indebtedness at beginning of year**	898,646	2,626,122
▶ **Bank indebtedness at end of year**	$ 2,114,837	$ 898,646

1. Significant Accounting Policies

(a) **Investments**
The Company's investments consist of investments in continuing and disposal restaurants, business facility leases, restaurant real estate and non-restaurant real estate. The methods of accounting for these investments are as follows:

(i) Continuing restaurants, business facility leases and restaurant real estate.
In order to provide more consistent and meaningful information the Company accounts for its investment in both subsidiaries and joint ventures (both incorporated and unincorporated) on the equity method. Accordingly these investments are included in the consolidated balance sheet as investments accounted for on the equity method and the Company's share of the net income is included in income from restaurant-related investments on the consolidated statement of income.

(ii) Disposal restaurants and non restaurant real estate.
The same accounting policy is followed for these investments as for those investments described in note 1 (a) (i) except that the Company's share of income is included in other income on the consolidated statement of income.

(b) **Inventories**
Inventories are stated at the lower of average or replacement cost and net realizable value.

(c) **Investments in assets held for disposal**
The Company's investment in assets held for disposal consist of the net proceeds expected to be realized by the Company during the next twelve months on the sale of certain restaurants owned by a subsidiary and non-restaurant real estate held for resale.

(d) **Restaurant operations**
Where the Company has acquired restaurant operations, the purchase price is allocated firstly to tangible assets with any balance attributed to goodwill. Equipment and furnishings are depreciated over a ten-year period with leasehold improvements and goodwill being amortized on a straight-line basis over the terms of the leases plus renewal options, to a maximum of twenty years.
Certain costs incurred by restaurants prior to opening are deferred and amortized on a straight-line basis over a five-year period from the date of commencement of operations. These costs would include advertising, training and site investigation.
Costs incurred by new concept restaurants during the first year of establishing the new concept are deferred and amortized on a straight-line basis over five years or are charged to income of the period in which it is determined that there will not be sufficient recovery from future operations. These costs include market development and operating losses.

(e) **Property, plant and equipment**
Property, plant and equipment are recorded at cost. Depreciation is calculated on a straight-line basis over twenty years for buildings and over ten years for equipment and furnishings. Leasehold improvements are amortized on a straight-line basis over the terms of the leases plus renewal options, to a maximum of twenty years.

(f) **Translation of foreign currencies**
Monetary assets and liabilities of the Company's U.S. subsidiary are translated at the year end rate of exchange. Non-monetary assets and liabilities are translated at the average exchange rate during the year of acquisition. Income accounts are translated at the average exchange rate for the year. Gains and losses resulting from these translation policies are recorded in the consolidated statement of income.

2. Related Party Transactions

The following related party transactions and balances are recorded in the accounts:

a) Advances and notes receivable from shareholders and their related companies;

Advances receivable	$ 108,483
Notes receivable, net of current maturity	$ 60,000

The advances are non-interest bearing and have no fixed terms of repayment. The notes receivable are non-interest bearing and consist of a loan of $80,000, repayable in annual instalments of $20,000.

b) Service and licence fees earned.	Service Fees	Licence Fees
Joint ventures	$ 3,453,603	$ 16,140
Wholly owned restaurants	1,522,859	1,250
Franchises	578,277	20,000
	$ 5,554,739	$ 37,390

During the year the Company acquired an officer's interest in three existing restaurants for a cash consideration of $975 plus the issue of 123,300 Class A Non-Voting shares of the Company at an assigned value of $524,025.
During the year the Company acquired from an officer a 25% interest in Eastern Steakhouse Ltd. for a cash consideration of $96,786 plus the issue of 45,000 Class A Non-Voting shares of the Company at an assigned value of $202,500.
During the year the amount receivable from shareholders and their related companies was reduced by a $239,000 preference share issue from a company related to a shareholder. These preference shares are included in investments.

3. Investments

Investments comprise:	**1984**	1983
Continuing restaurant-related investments, at equity		
Restaurants (joint venture and wholly-owned)	**$ 17,190,707**	$ 20,859,090
Business facility leases	**4,607,034**	600,416
Restaurant real estate	**3,066,256**	3,691,103
	24,863,997	25,150,609
Non-restaurant real estate, at equity	**3,069,386**	2,470,175
Other investments, at equity	**552,283**	4,354,705
	$ 28,485,666	$ 31,975,489

The comparative numbers have been reclassified to conform with the format adopted for 1984. Business facility leases are the fixed assets of one or more restaurants owned by the Company, subsidiaries of the Company or incorporated joint ventures. These assets are leased to separate operating entities in exchange for a percentage of sales.

Income from investments consisted of:		
Restaurant-related investments:		
Restaurant operations	**$ 487,273**	$ 910,344
Business facility leases	**38,156**	13,531
Restaurant real estate	**98,051**	128,367
	$ 623,480	$ 1,052,242

The following condensed financial information is provided for subsidiaries which have been accounted for using the equity method:

Total assets	$ 33,010,630
Total liabilities	$ 14,749,639
Equity in net assets, being carrying value	18,260,991
	$ 33,010,630

The assets, liabilities, revenues and expenses of joint venture restaurants considered significant are reported or disclosed as appropriate.
The company is contingently liable in respect of joint venture and subsidiary borrowings as follows:

(i) as guarantor of restaurant loans to the extent of $8,997,186, and
(ii) as a party to the loan agreement relating to the Old Spaghetti Factory joint venture companies to the extent of $2,077,486. To facilitate this borrowing the loan was made in the name of the Company and the Company, in turn, entered into an agreement with The Old Spaghetti Factory joint venture companies whereby they each assumed their proportionate share of the debt. While the Company is the primary borrower, for

financial statement purposes, this loan is disclosed herein as a contingent liability rather than a direct liability on the balance sheet, in order to more consistently present the financial position as it relates to the Company's liabilities under the terms of the various joint venture financing arrangements. Under the terms of the loan agreement the Company has pledged certain of its assets as security. In addition, a wholly-owned subsidiary of the Company has pledged certain of its real estate as security.
The loan agreement provides for an early maturity bonus payment, which, based on present conditions, is likely to become payable in 1986. The amount of the bonus is not determinable until some time in the future.

(iii) as guarantor of real estate loans to the extent of $3,395,000.
(iv) as guarantor of business facility leases loans to the extent of $7,915,247.

4. Fixed Assets

	1984	1983
Land and buildings	$ 1,628,053	$ 1,628,053
Leasehold improvements	15,115	—
Equipment and furnishings	228,570	242,172
	1,871,738	1,870,225
Less accumulated depreciation and amortization	265,516	155,972
	$ 1,606,222	$ 1,714,253

5. Bank Indebtedness

Bank indebtedness is secured by a general assignment of book debts, a floating charge demand debenture, and a fixed charge on certain real estate.

6. Long Term Debt

	1984	1983
Long term debt comprises:		
Debentures	$ 8,295,841	$ 8,793,925
Mortgage	528,000	624,000
Term bank loan	5,277,246	4,811,665
Promissory notes	2,247,659	2,027,500
Agreements	283,923	490,172
	16,632,669	16,747,262
Current maturity	5,890,050	3,127,479
	$ 10,742,619	$ 13,619,783

(a) **Debentures**
Of these debentures, $295,841 bears interest at prime rate plus 2% and matures October 15, 1985. This debt is secured by a fixed charge on the Company's investment in various joint venture and subsidiary companies and by a floating charge on all other non-current property and assets of the Company.
The balance of $8,000,000 represents a series of 11% convertible, subordinated debentures. These debentures are convertible into Class A non-voting shares at a conversion price of $6 per share until July 29, 1988 and at $6.50 per share thereafter until maturity. The Company, at its option, at any time after July 29, 1988, may redeem these debentures at premiums ranging from 10% in the year ended July 29, 1989 reducing at 2½% per annum to maturity date at July 29, 1993. These debentures are unsecured and subordinate to all indebtedness of the company other than indebtedness or liability to creditors for accounts payable in the ordinary course of business.

(b) **Mortgage**
The mortgage bears interest at prime rate plus 2% and is secured by land, building and restaurant assets located in Tacoma, Washington.

(c) **Term bank loans**
These loans bear interest at prime rate plus 1% to 1½% and are secured by a general assignment of book debts, a floating charge demand debenture and a fixed charge on real estate.

(d) **Promissory note**
These notes bear interest at rates from 10% to prime rate plus 2% and mature at various dates to 1987. One of these notes is secured by land and a building located in Montreal,

Quebec. A second note bears interest at 10% and is convertible into Class A non-voting shares at a conversion price of $6 per share until July 29, 1985. If the conversion option is not exercised the debt becomes payable in three equal annual instalments bearing interest at prime rate plus 1%.

(e) **Agreements**
$118,787 of these agreements are non-interest bearing, the remainder of the agreements bear interest at rates currently ranging from 13% to 15%. The agreements mature at various dates to 1987.

(f) **Principal repayments**
Excluding convertible debt, the minimum principal payments on long term debt for the next five years are as follows:

1985	$ 5,890,050
1986	1,238,085
1987	1,487,634
1988	16,900
1989	—

7. Capital Stock

	1984	1983
The Company's issued capital stock comprises:		
858,863 common shares, net of employee stock purchase plan	$ 487,702	$ 528,642
7,102,653 class A non-voting shares, net of employee stock purchase plan	18,016,807	16,252,105
	$ 18,504,509	$ 16,780,747

The common share and class A non-voting share transactions during 1984 were as follows:

Common Shares	**Number of Shares**	**Amount**
Balance December 31, 1983	**895,093**	$ 528,642
Payments received under the employee stock purchase plan	—	22,100
Converted to Class A non-voting	**(36,230)**	(63,040)
	858,863	$ 487,702
Deduct shares owned by the Company	**126,002**	
	732,861	

Class A non-voting shares	**Number of Shares**	**Amount**
Balance December 31, 1983	**6,748,961**	$ 16,252,105
Issued		
Converted from common	**36,230**	63,040
Pursuant to acquisition of shares of joint venture companies	**203,800**	859,525
Conversion of warrants	**22,075**	86,300
Stock dividend	**91,587**	302,237
Payments received under the employee stock purchase plan	—	453,600
	7,102,653	$ 18,016,807
Deduct shares owned by the Company	**926,655**	
	6,175,998	

14,474 of the Class A non-voting shares were issued from treasury stock to acquire the minority interest of a subsidiary.

The total amount now outstanding under the employee stock purchase plan is $585,100 and is repayable as follows:

1985	$ 181,180
1986	134,640
1987	134,640
1988	134,640
	$ 585,100

These notes are non-interest bearing and have been deducted from share capital for financial statement purposes. Payments are added to share capital as they are received.

▶ 8. Income Taxes

The income tax recovery of $1,310,008 differs from the result that would be obtained by applying the combined Canadian Federal and Provincial income tax rate of 52% to the loss before income taxes and extraordinary items. The difference results from the following items:

	Impact on Tax Benefit	% of loss before Income Taxes and Extraordinary Items
Computed "expected" tax recovery on loss before income taxes and extraordinary items of $1,658,900	**$ 862,628**	52%
Net portion (amounting to $301,438) of gains in joint venturing; gains on sale of investments and loss in value of restaurant investments which are not subject to tax	**156,748**	9.4%
Investment income in the amount of $558,908 reported after tax	**290,632**	17.5%
	$1,310,008	78.9%

At December 31, 1984 a U.S. subsidiary of the Company has the following loss carryforwards available to reduce future years' income for tax purposes, the tax benefits of which have not been recorded in the accounts. These losses expire in the following years:

1995	$ 184,380
1996	$ 55,000

▶ 9. Commitments

The Company, its subsidiaries and joint ventures have lease commitments which expire in one to twenty-two years. The approximate aggregate annual rentals payable over the next five years on these leases, excluding additional payments based on sales, will be as follows:

1985	$ 5,025,341
1986	4,610,626
1987	4,137,681
1988	3,765,901
1989	3,408,251

▶ 10. Regional Operations

The following table summarizes the Company's licensing income and income from continuing restaurant-related investments on a regional basis:

1984 *(stated in $000's)*

	British Columbia	Alberta	Central	Eastern	United States	Total
Sales	$53,772	$19,854	$16,987	$53,846	$5,911	$150,370
Fees	$ 1,893	$ 870	$ 446	$ 2,144	$ 202	$ 5,555
Gain on sale of joint venture interests	68	102	24	160	20	374
Investment income	268	351	123	(259)	140	623
	2,229	1,323	593	2,045	362	6,552
Regional Support	417	106	9	849	—	1,381
	$ 1,812	$ 1,217	$ 584	$ 1,196	$ 362	$ 5,171
Corporate support						$ 1,784
Total restaurant-related income						3,387
Other income (expense)						(532)
						2,855
Corporate administration and interest						4,514
Loss before taxes and extraordinary item						$(1,659)
Investment carrying value	$ 3,765	$ 2,676	$ 1,004	$11,009	$3,344	$ 21,798

	1983 (stated in $000's)					
	British Columbia	Alberta	Central	Eastern	United States	Total
Sales	$51,910	$18,029	$15,291	$44,898	$9,492	$139,620
Fees	$ 2,140	$ 849	$ 346	$ 1,913	$ 236	$ 5,484
Gain on sale of joint venture interests	124	367	157	35	—	683
Investment income	509	475	29	188	(149)	1,052
	2,773	1,691	532	2,136	87	7,219
Regional support	340	171	36	425	33	1,005
	$ 2,433	$ 1,520	$ 496	$ 1,711	$ 54	$ 6,214
Corporate support						$ 1,438
Total restaurant related income						4,776
Other income (expense)						695
						5,471
Corporate administration and interest						2,563
Income before taxes and extraordinary item						$ 2,908
Investment carrying value	$ 4,664	$ 4,139	$ 390	$ 9,979	$2,287	$ 21,459

11. Extraordinary Items

The extraordinary items consist of the loss in value of certain non-restaurant real estate investments held by the Company and additional costs relating to a restaurant concept abandoned in 1983 net of gains on sale of certain restaurants originally acquired as long term investments in the 1983 acquisition of Controlled Foods International Ltd. The amount is also net of the income tax benefit of $1,201,108 related thereto.

12. Earnings Per Share

The earnings per share figures are calculated using the weighted monthly average number of shares outstanding. The weighted average number of common shares used to calculate the basic and fully diluted earnings per share has not been increased for the potential effects of conversion of convertible debt as this would decrease the calculated loss per share both before and after extraordinary items.

13. Comparative Figures

Certain 1983 financial statement items have been reclassified to conform with the presentation adopted for 1984.

Keg Restaurants Ltd.

Directors

David Aisenstat *Executive Vice President, Hy's of Canada*
David W. Betts *President, Betts Electric Ltd.*
J.W. Bradley Bond *Senior Vice President, Eastern Operations, Keg Restaurants*
Harold P. Capozzi *President, Capozzi Enterprises Ltd.*
Arthur H. Crockett *Corporate Director and Financial Consultant*
Winton Derby *Senior Partner, Shrum, Liddle & Hebenton*
Maxwell Goldhar *Chairman, Revenue Properties Company Ltd.*
J. Boyd Matchett *Executive*
George M. Tidball *President, Keg Restaurants Ltd.*

Officers

George M. Tidball *President and Chairman of the Board*
J.W. Bradley Bond *Senior Vice President, Eastern Operations*
Wayne Holm *Senior Vice President, Corporate Support Services*
Terry Thompson *Secretary Treasurer*
L. Bruce Benda *Vice President*
Dunc Holmes *Vice President, Corporate Communications*
Kurt Landert *Vice President, Food Services*
Eugene Ruelle *Vice President, Training & Development*

Registrar and Transfer Agent

National Victoria and Grey Trust Company Limited, Vancouver, B.C.

Auditors

Thorne Riddell, Chartered Accountants, Vancouver, B.C.

Solicitors

Shrum, Liddle & Hebenton, Vancouver, B.C.

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